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Financial Markets

Irving Trust

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"Waiting for the Robert E. Lee" was once a major pastime along the banks of the Mississippi, an activity with parallels in today's financial markets. The theme used to be "Waiting for the Money Supply," but that has lost ground with the Fed's de-emphasis of the weekly money numbers, and Fridays are no longer what they were. Instead, a new favorite has emerged--"Waiting for the Discount Rate Cut"--and guesses on the timing of that cut are a central current market preoccupation.

That about sums up activity over the past two weeks--short-term rates moved up and down, but showed very little net change, with a discount rate cut the necessary (and generally expected) trigger for the next movement in rates. Fed funds gave no directional impetus, holding steady in a 9.2%-9.5% range (except on Wednesday), while 90-day CDs traded in an 8.9%-9.2% range at a relatively narrow (100 basis points) spread over 91-day bills. No prime rate cuts, no big shifts in commercial paper rates, not really much of anything--it all hangs on the discount rate cut.

Long-term markets were marginally more positive--the new 30-year Treasury bond was well received, and long-term rates edged down in most markets. Here too, however, the discount rate cut is key, since long-term markets are priced at relatively high levels vs. financing costs. This means that if financing costs do not drop (a discount rate cut would presumably push down Fed funds and RPs, at least at first), current price levels in long-term debt markets would look a bit vulnerable. That has inhibited enthusiasm in long markets, limiting price gains.

So when will the discount rate be cut? Hopes for a postelection move were not fulfilled, and expectations of action today have shifted to Monday, November 15, when October M2 data will be released. With M2 growth estimated to have dropped to a 6% annualized rate, that could be a suitable occasion for a discount rate cut. Another possibility is after the Federal Open Market Committee meeting on Tuesday, November 16, with action generally expected by next Friday at the latest.

Note that the question is when, not if, the discount rate will drop. Most market watchers are convinced that the rate will be cut at least once and very possibly twice before year-end. This conviction stems from the combination of a very weak economy and a declining inflation rate--in these circumstances, the argument goes, the Fed's course is clear and has been clearly indicated by policy moves since last July. If the discount rate is not cut next week, that conviction could begin to waver, putting downward pressure on current price levels.

A final note--the thin spread on CDs over bills (100 basis points vs. 300 last August) is interesting, given continuing international debt problems. The lack of response to talk about a Brazilian approach to the IMF points to a substantial lessening in worry about banks. One reason may be the fact that debt problems have not been making headlines; another may be the significant shifts in U.S. (and other) government policy on international debt, with IMF support now high on the agenda. Debt problems may well be more publicized over the next month or two, which could test the markets' current calm assessment of credit risks.

Anne Parker Mills

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Market Yields

	11/12/82 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	12.00%	12.00%	17.00%
Effective since	10/13/82		
Discount Rate at Federal Reserve Bank	9.50	9.50	13.00
Federal Funds	9.50	9.25	13.13
Repurchase Agreements	9.13	9.25	12.50
U.S. Treasury Issues			
Bills			
3 months	8.48	8.01	11.30
6 months	8.92	8.70	12.21
1 year	9.15	8.99	12.34
Coupons			
2 years	9.81	9.71	12.85
4 years	10.29	10.20	13.24
7 years	10.58	10.48	13.40
10 years	10.54	10.47	13.20
Long Bond	10.42	10.69	13.27
Negotiable Certificates of Deposit-Secondary Market			
1 month	8.95	8.85	12.60
3 months	9.10	8.95	12.55
6 months	9.30	9.10	12.80
1 year	9.75	9.50	13.00
Banker's Acceptances			
1 month	8.85	8.70	12.65
3 months	8.90	8.90	12.50
6 months	8.95	9.05	12.65
Eurodollar Deposits			
1 month	9.63	9.38	13.00
2 months	9.75	9.50	13.13
3 months	9.88	9.75	13.25
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.75	8.63	12.75
1 month	8.75	8.63	12.50
3 months	8.50	8.50	12.38
Bank Holding Companies			
1 month	7.75	8.50	12.00
Dealer Placed:			
3 months	8.13	8.38	12.45
New AA Corporate Utility Bond	11.90	12.00	16.10
Tax Exempt			
6 month Project Notes	4.00	4.30	6.50
1 year AAA Bond	5.50	5.50	7.90
5 year AAA Bond	7.00	7.00	8.50
20 year AAA Bond	9.40	9.30	11.60

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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